

Service Date: June 30, 1998

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

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IN THE MATTER of the Application of)	UTILITY DIVISION
U S WEST Communications, Inc. for)	
Authority to Flexibly Price Regulated)	DOCKET NO. D97.7.125
Telecommunications Services in Certain)	
Local Exchanges.)	ORDER NO. 5998d

FINAL ORDER

I. Introduction and Procedural Background

1. On July 17, 1997 U S WEST Communications, Inc. (U S WEST) filed an application with the Montana Public Service Commission (Commission) to flexibly price some of its regulated telecommunications services in its Glendive and Terry exchanges. The filing was designated Docket No. D97.7.125 and the Commission issued a notice of the application permitting interested parties to intervene and/or comment on the filing. Montana Consumer Counsel (MCC), AT&T Communications of the Mountain States, Inc. (AT&T), Montana Wireless, Inc. (MWI), MCI Telecommunications Corp (MCI), and Montana Independent Telecommunications Systems (MITS) petitioned for and were granted intervention

2. In its application, U S WEST explained that the purpose of this filing is to allow it to flexibly price services in order to respond to actual competition from a competitive local exchange carrier (CLEC) which is either a facilities based provider or which provides competing local exchange services using U S WEST's unbundled network elements. The application states

that because U S WEST is currently authorized to offer only point rates for the regulated telecommunications services listed in Appendix 1 of the filing, it cannot effectively compete with Mid-Rivers Telephone Cooperative (Mid-Rivers) for its own customers in the two exchanges. U S WEST claimed that to effectively compete with Mid-Rivers in Terry and Glendive, it needs authority to flexibly price such services. The services affected include business lines, Centrex station lines, Centrex 21 ISDN 2B+S, hunting, custom calling services, PBX business trunks, and computer port access.

3. U S WEST asserted in the application that Commission approval of the proposed tariffs would encourage competition, allow an orderly transition from a regulated telecommunications market to a competitive market environment, and would be in the public interest. The partial detariffing requested consists of establishing the current point rate as the maximum rate, and the TSLRIC (total service long-run incremental cost) with some contribution to shared cost as the minimum rate.

4. The Commission approved U S WEST's filing on an interim basis on August 5, 1997, pending the outcome of the hearing and final decision in this matter. On that basis, U S WEST could price services listed in Appendix 1 of the initial filing anywhere within the range established by the minimum and maximum rates.

5. In addition to the request for interim authority and a hearing, U S WEST requested a determination that its application is complete, or, alternatively, for a waiver of any rules necessary for the Commission to deem the application complete. The Commission directed staff to establish a procedural schedule; a Procedural Order was subsequently issued and a hearing set for February 4, 1998.

6. On January 2, 1998, U S WEST filed a Motion requesting the Commission to issue an order vacating the February hearing date, determining that the case should be decided on the basis of a stipulated record consisting of the prefiled testimony from U S WEST's two witnesses and MITS' witness, and establishing a briefing schedule. U S WEST represented that all intervening parties had agreed that the prefiled testimony could be stipulated into evidence without cross-examination or personal appearance by the witnesses, and, therefore, a hearing was unnecessary. The Commission granted U S WEST's motion, vacated the remainder of the procedural schedule, set a briefing schedule, and established the record consisting of: (1) the prefiled testimony of James B. Hayhurst, Geraldine Santos-Rach, and Mike Strand; and (2) U S WEST's responses and supplemental responses to PSC Data Requests 001-012. *See* Order No. 5998b (Jan. 13, 1998). The Commission makes the following findings, conclusions and order.

II. Findings of Fact and Commission Decision

7. U S WEST's July 17, 1997 filing requested authority to partially detariff and flexibly price certain regulated telecommunications services in certain local exchanges.¹ Although approval of the U S WEST tariff filing will establish a tariff process to allow pricing flexibility in exchanges where facility based competition is presently occurring by one competitor, U S WEST intends to make specific filings prior to offering discounted prices in other

¹ In addition to the labels "flexible pricing" and "detariffing", U S WEST refers to the filing as competitive zone pricing; Competitive Zone Pricing is a form of flexible pricing for specified Company services in any local exchange area where local service is being offered or provided by a competing facilities-based provider or by a CLEC through the purchase of unbundled elements pursuant to an interconnection agreement with the Company.

competitive exchanges. *See* U S WEST's response to PSC -003(c).² Specific filings will include actual discounted price information.

8. Mid-Rivers negotiated an interconnection agreement with U S WEST which has been approved by the Commission. That agreement provides for facilities-based interconnection only; Mid-Rivers will not purchase unbundled network elements from U S WEST or resell U S WEST's services under their agreement. According to U S WEST, the facilities based interconnection agreement between Mid-Rivers and U S WEST triggered this flexible pricing application.³

9. U S WEST filed testimony by Mr. Jim Hayhurst and Ms. Geraldine Santos-Rach. Mr. Mike Strand testified on behalf of MITS.

10. Section 69-3-807(2)(c), MCA, authorizes the Commission to "establish only maximum rates, only minimum rates, or permissible price ranges as long as the minimum rate is cost compensatory."

² Although U S WEST asserts to make such filings in "competitive exchanges", U S WEST declined the offer to explain whether there is workable or effective competition in Terry. *See* U S WEST's response to PSC -004(e).

³ *See In the Matter of the Application of Mid-Rivers Telephone Cooperative Pursuant to Section 252(e) of the Telecommunications Act of 1996 for Approval of its Interconnection Agreement With U S WEST Communications, Inc.*, Docket No. 97.2.19, Order No. 5981 (April 29, 1997).

11. An August 12, 1997 Notice of Commission Action granted U S WEST interim approval to flexibly price in the Terry and the Glendive exchanges. In March of 1998, the Commission approved a specific tariff filing, permitting U S WEST to flexibly price Centrex 21 service in Glendive.

U S WEST: Mr. Hayhurst's Testimony

12. Mr. Hayhurst's testimony explains that U S WEST wants to price flexibly if two conditions are met: (1) that a competitive local exchange carrier exists which is facility based or uses unbundled network elements and is capable of providing local exchange service in a particular exchange; and (2) a competitive local exchange carrier provides or offers to provide local exchange service in a particular exchange. Mr. Hayhurst qualified the first condition, testifying that a CLEC will not be considered a "competitor" if the Commission continues to prohibit what U S WEST terms as "sham unbundling" and the CLEC does not provide switching or loop elements, but purchases U S WEST's unbundled elements. U S WEST seeks the ability to flexibly price in Terry and Glendive where, according to Mr. Hayhurst, it faces such competition.

13. Mr. Hayhurst explained that U S WEST requested interim approval of flexible pricing instead of seeking to use the forbearance authority permitted by the Montana Telecommunications Act in § 69-3-808, MCA. He stated that U S WEST needs interim approval, otherwise it will have to "win back" customers. The forbearance statute involves an unwieldy process which essentially creates individual customer tariffs; the flexible pricing tariff, on the other hand, permits a simpler and more streamlined process where numerous customers may be involved.

14. Mr. Hayhurst further discussed U S WEST's proposed flexible pricing policies, stating that U S WEST intends to flexibly price recurring charges for the following services: (1) flat-rated business and additional business lines; (2) flat-rated computer port access and PBX business trunks; (3) Centrex 21 ISDN 2B+S and Centrex Analog Station Line; (4) hunting;

(5) call waiting; and (6) Package - call waiting/call forwarding variable. Any flexibly priced service will be subject to maximum and minimum prices. The minimum price equals the total service long-run incremental cost (TSLRIC) plus shared costs. The maximum price is the existing tariff rate on July 17, 1997 when U S WEST filed its application.

15. Mr. Hayhurst also explained why U S WEST did not seek flexible pricing for residential exchange access. In his judgement, the relevant cost already exceeds the current price; therefore, any price decrease would exacerbate the current subsidy. That is, even though U S WEST claims that residential basic exchange service is cross subsidized and its TSLRIC's are cost based, U S WEST contends that it would not save any money if and when a Terry or Glendive customer switched from U S WEST to Mid-Rivers: "The cost of maintaining its facilities will remain, but revenues will evaporate." *See* U S WEST's response to Data Request PSC -006(b).

U S WEST: Ms. Geraldine Santos-Rach's Testimony

16. Ms. Geraldine Santos-Rach sponsored U S WEST's total service long run incremental cost (TSLRIC) studies that U S WEST uses to set minimum prices. Her testimony lists the services U S WEST seeks to detariff. She provided general reasons for using TSLRIC and described the TSLRIC method. She also stated that the cost studies in this docket, except for Centrex 21, can be referenced to her testimony in Docket No. 96.12.220, U S WEST's Rate Rebalancing filing. *See* Data Request PSC-001.

17. Ms. Santos-Rach testified that U S WEST seeks to apply TSLRIC to basic business, call waiting, hunting and Centrex 21. She clarified U S WEST's intent to detariff services provided only within the base rate area of the specific exchanges. She further testified

that U S WEST does not seek flexible pricing for any service outside the base rate area, nor does it seek to detariff non-recurring charges.⁴

18. Ms. Santos-Rach explained why U S WEST performs incremental cost analyses. Termed direct costs, TSLRIC is the forward-looking cost avoided (or added) by discontinuing or (offering) an entire service in the most efficient manner in the long term. Without reciting the actual principles, she asserted that U S WEST, AT&T, MCI and others agreed to a set of consensus cost principles in an Arizona state forum on telephone costing. She testified that the principles capture the essence of TSLRIC, although the parties disagree on how to apply the principles.

19. Ms. Santos-Rach testified that U S WEST performs TSLRIC studies for two reasons. One reason is to mitigate an entrant's concerns that an incumbent local exchange carrier might subsidize services to prevent economic entry by competitors. TSLRICs must be used because embedded, accounting, cost-based prices cannot achieve this goal. The second reason is to avoid cross subsidies. Unit costs are one of U S WEST's cross subsidy barometers. She asserted that prices in excess of TSLRIC are not subsidized.

20. Ms. Santos-Rach outlined the general steps to perform a TSLRIC study for recurring charges. A service's product components and network elements (e.g., drop lines and

⁴ Ms. Santos-Rach distinguished recurring and non-recurring costs. Recurring costs are investment-related while non-recurring costs are associated with one-time expenses to establish service. Ms. Santos-Rach emphasized that it is not U S WEST's intent to detariff non-recurring costs at this time.

loops) are first defined. Next, the "inputs of service" and the related and expected service demand are identified. One then calculates the forward looking investment for "network resources." The investment is divided by the demand and added to relevant expenses. According to Ms. Santos-Rach, examples of relevant volume-sensitive and volume-insensitive expenses include capital costs, taxes, and administrative costs.

21. Ms. Santos-Rach testified that TSLRIC is not sufficient for pricing. Both shared and common costs must be added and recovered. She associates shared costs with those direct costs incurred to provide multiple services or a service family. She added that shared costs exist until U S WEST discontinues an entire service.

22. In addition to shared costs, Ms. Santos-Rach's testimony recited the Federal Communications Commission's (FCC) policies on common costs. She stated that the FCC encourages the assignment of common costs to TELRICs, although TELRICs differ from TSLRICs.⁵ Ms. Santos-Rach testified that common costs may range between 20 and 25 percent above the service and shared costs depending on the jurisdiction.

Montana Independent Telecommunications Systems (MITS)

23. Mr. Michael Strand testified on behalf of MITS, the only other party to file testimony. Mr. Strand's testimony raised several issues about the potential for this docket to set a precedent for future proceedings that might involve MITS' members. Mr. Strand testified he is

⁵ TELRIC is the FCC's cost basis for wholesale prices. State commissions may use TSLRIC for retail pricing.

unaware of benchmarks to determine when market power is sufficiently eroded to justify flexible pricing for a regulated independent local exchange company or to deregulate a service. He asserted that MITS is loathe to take a case-by-case approach to determine the extent of competition. He supports development of objective criteria to govern granting of pricing flexibility to incumbent local exchange carriers which distinguish between small and large companies. Mr. Strand suggests the Commission consider making a regulatory determination of the extent of competition.

24. Mr. Strand added that the Commission is challenged to develop and implement equitable regulatory constraints for an industry in the throes of changing from a natural monopoly to increasing competition. As evidence of this challenge he noted an apparent conflict between U S WEST's proposals. He asserted that on one hand, U S WEST seeks to raise residential rates in Docket No. 96.12.220, and on the other hand, U S WEST seeks to lower residential rates in this docket.

25. In conclusion, Mr. Strand's testimony cautions the Commission to keep in mind the distinction between large and small independent local exchange companies. While not condemning flexible pricing, he reminds the Commission of the "80/20 rule"--20 percent of the customers generate 80 percent of the revenue.⁶ Mr. Strand testified that although it may appear that effective competition has developed in an exchange such as in Terry, it does not follow that

⁶ This rule appears to derive from the testimony of U S WEST's witness, Mr. McGinnis, during the hearing in Docket No. D96.12.220 (TR 25).

U S WEST actually faces effective competition where U S WEST has lost only about 200 of a total of 400,000 access lines.

Flexible Pricing Implemented

26. In a February 19, 1998 transmittal, U S WEST filed to implement flexible pricing. U S WEST's filing requested authority to introduce a new flexible rate for Centrex 21 in the Glendive exchange. The filing also sought approval of a promotion to temporarily waive non-recurring charges for customers ordering Centrex 21.⁷ U S WEST revised this initial filing twice.⁸ The Commission approved U S WEST's filing on March 10, 1998.

Summary of the Arguments

27. U S WEST, MITS and MWI filed briefs in this Docket. U S WEST's opening brief asserted that no party opposed its filing and concluded that its proposal is both pro-competitive and pro-consumer. MITS' took issue with U S WEST's statement, asserting that although it did not oppose U S WEST's application, it also did not support the application.

⁷ U S WEST stated that "basic local exchange service" means voice grade local access service such as 1FR and 1FB services. In its February 20 filing, U S WEST revised Section 16.1 Special Promotions (Cont'd) to read:

During a promotional period from the effective date of this Page 9, Release 5 through April 17, 1998, business customers in the Glendive Exchange will receive a waiver of the nonrecurring charges or conversion charges associated with Analog Centrex 21 station lines when converting from another service, when adding additional Analog Centrex 21 station lines or when a customer returns to the Company. This only applies for the customer's initial return to the Company. This promotion is available on all orders placed and/or completed during the promotional period or at the next available offered due date.

Service promotions, other than for basic local exchange assess, do not require advance Commission approval [69-3-305(5)(a)].

⁸ Another revision changed the location of the filing in U S WEST's tariff. Then, on February 26, 1998, U S WEST revised the filing to limit the offering to business customers inside the Glendive base rate area. This last revision revised costs to be consistent with the offering's limitations and to be consistent with this Docket.

28. MITS and MWI do not necessarily agree with U S WEST that the filing is both pro-competitive and pro-consumer. MWI's reply brief addresses policy issues raised in U S WEST's opening brief, rebutting U S WEST's assertion that there are no policy considerations that militate against approval. To the contrary, MWI believes U S WEST's application should be denied on public policy grounds.

29. MWI expressed concerns that the Commission's decision might "set the stage" for U S WEST to implement similar changes in other exchanges where competition does not develop as rapidly as it has in the Glendive and Terry exchanges in which Mid Rivers is operating. MWI is concerned that there will be other circumstances where competition will emerge in a significantly different manner and which may not warrant the sort of pricing flexibility pursued by U S WEST in this proceeding. MWI is also concerned that U S WEST will be able to implement flexible pricing where it may not be warranted and without the input from interested parties.

30. MITS shares these and other concerns expressed by MWI. Both are concerned that this case may set precedent for other areas of Montana where flexible pricing may not be appropriate. MWI strongly argues that the Commission should strictly limit any flexibility granted in this Docket to the Terry and Glendive exchanges. MWI reasons that, "The fact remains that U S WEST maintains sufficient market force and market power to effectively squelch competition." MWI further argued that U S WEST should not be allowed to deviate from statutorily required statewide averaging without a "compelling showing that its network has

been fully opened to facilities-based local competitors, including full and open access to U S WEST's operational support systems."⁹

31. MITS emphasizes that § 69-3-807(2)(c), MCA, requires the Commission to consider such factors as the size of the alternative providers in question and the extent to which services are available from alternative providers in the relevant market. MITS further notes the size of the alternative provider in this proceeding, Mid Rivers, and the probable differences in a larger market such as the Billings area. MITS states that it shares the concerns expressed by MWI, but perhaps for different reasons: MITS members would like to clearly understand the extent of their ability to flexibly price their own regulated services if and when they face competitors in their service territories, and, if and when they choose to compete, they believe a clear understanding of the incumbent's ability to price flexibly is critical to evaluating the likelihood of success.

32. MWI also argues that U S WEST's application does not further the declared policies of the state of Montana. MWI notes that § 69-3-807(2), MCA, states that the Commission may authorize an alternative form of regulation when it best serves the declared policy of the state. The legislature's declared policy is included in § 69-3-802, MCA, and states, *inter alia*, that the policy of the state is to encourage competition in the telecommunications industry to the extent that it is consistent with maintaining universal service. MWI asserts that U S WEST

⁹These issues are being addressed in Docket No. D97.5.87, the Commission's review of U S WEST's compliance with § 271 of the Telecommunications Act of 1996.

conveniently excluded any testimony concerning universal service, and, further, that the application does not further this primary policy goal. MWI argues that approving U S WEST's application poses a possible adverse impact on the development of competition in Montana and that significant policy issues concerning rate rebalancing are involved which should be considered in another proceeding. MWI further argues that U S WEST has made no compelling showing that the statewide average rate requirement in § 69-3-807(5) should be altered and has not justified deviation from historical monopoly regulation. These "significant policy issues" raised by MWI seem to refute U S WEST's statement that no party opposed its filing in this matter.

33. In response to MWI's assertion that the application does not promote universal service, U S WEST asserts that the Montana Legislature's universal service goal is not the single trump card MWI makes it out to be. For the very reason MWI asserts flexible pricing does not promote universal service, U S WEST holds the reverse is true: flexible pricing promotes universal service. To buttress its defense, U S WEST cites to earlier Commission decisions granting flexible pricing. Those decisions involve Montana Dakota Utility's gas Docket No. 87.1.8 and Montana Power Company's ASiMI filing in Docket 96.6.106.

34. MWI also argues that U S WEST's request is inconsistent with its recent legislative advocacy. MWI raises an issue that results from U S WEST's advocating the use of different costing for TELRIC and TSLRIC purposes. MWI holds that as a result of this filing, U S WEST may price a retail service below the comparable unbundled network element price. MWI asserts this will stifle the development of competition in Montana.

35. MITS noted the requirement in § 69-3-807(2)(c), MCA, that minimum rates be cost compensatory, adding that the Commission must consider the factors set forth in § 69-3-807(3)(a)-(e), MCA. MITS concludes that the statute does not provide needed guidance. We note, however, that if the minimum rates are cost compensatory, § 69-3-807(4), MCA, permits the Commission to exercise its authority under § 807 if it finds that the action is consistent with § 69-3-802, MCA, and the public interest. MITS did not address this section.

36. MWI recommends amending U S WEST's proposed tariff to limit the availability of flexibility pricing service. In lieu of adding other exchanges by simply filing a modified tariff page, MWI recommends requiring U S WEST to make an additional filing so that interested parties can respond. In response, U S WEST's states that it fully intends to expand the tariff in response to competitive activity, but it will not expand any flexible pricing authorization beyond Terry and Glendive without first filing an application.

Commission Analysis

37. The Commission recognizes the concerns voiced by MITS and MWI that approval of U S WEST's flexible pricing tariff in this Docket should not permit subsequent flexible pricing applications that do not afford interested parties the opportunity to provide their input in the form of either comments or testimony. The competitive market that Mid-Rivers has established in Glendive and Terry appears to be unusual and may uniquely differ from the conditions that emerge in other Montana communities. The Commission agrees that any subsequent U S WEST applications for pricing flexibility in additional exchanges may require

differing analyses and ultimate decisions.¹⁰ The specific circumstances may call for an analysis using the factors in § 69-3-807(a)-(e), MCA.

38. This decision simply approves on a final basis flexible pricing for U S WEST in the Glendive and Terry exchanges. The Commission is not granting U S WEST a "blanket" pre-approval of a specific change in the structure or of any prospective and specific application. Interested parties will have every opportunity to comment or testify on any subsequent flexible pricing filings made by U S WEST. If this case-by-case approach to flexible price filings becomes unwieldy, the Commission may pursue a more generic approach to determine the extent of competition when and if that is warranted.

¹⁰ U S WEST, for example, asserts that "competition is imminent in Missoula." That competition would arise with MWI whose parent company is BTC Holdings, Inc. See response to Data Request PSC-003(e).

39. Although the Commission approves U S WEST's flexible pricing, it is not yet clear that effective competition will be permanently established in this market. *See, e.g.*, Data Request PSC-004. The long term competitive equilibrium of the market structure, in this case Terry and Glendive, is not at all clear. *See* Data Request PSC-002. We question whether both U S WEST and Mid-Rivers could survive a price war and whether an unfettered duopolistic market structure is sustainable in the longer term. In this regard, U S WEST asserts that cooperatives are self-regulated and Mid-Rivers is undoubtedly aware of the possible financial implications of its market entry. U S WEST also cites explicit subsidies and tax inequities as reasons why Mid-Rivers may be able to compete in Terry and Glendive.¹¹ *See* U S WEST's response to Data Request PSC-004(b).

¹¹ These explicit subsidies include a weighting on dial equipment minutes that permits Mid-Rivers to recover up to three times its interstate switching costs and the \$286 per access line Mid-Rivers receives from the Interstate Universal Service Fund. *See* Data Request PSC -008(e).

40. Second, this final approval does not address the merit or accuracy of U S WEST's TSLRICs or the alleged existence of cross subsidies. Even in the rebalancing docket, in which costs were debated, U S WEST and the MCC could not agree to the relevance and accuracy of U S WEST's TSLRIC model and TSLRIC cost results.¹² Because the Commission's concerns with U S WEST's TSLRIC rightfully belong in a cost of service docket, the final approval of flexible pricing in this case allows U S WEST to use TSLRIC plus shared costs as a cost compensatory minimum rate. Therefore, it would be misplaced to give TSLRIC any more credence in this docket than the U S WEST and MCC stipulation confers on the U S WEST model in the ongoing rate rebalancing docket. This Commission's decision in this Docket is not to be construed as a Commission approval of U S WEST's TSLRIC model.

41. By allowing U S WEST to flexibly price, U S WEST's rates are deaveraged. However, the Montana Telecommunications Act permits the Commission to authorize such rates as long as the resulting minimum rates are cost compensatory. Section 69-3-807(2)(c), MCA. In this regard, and although TSLRIC is not transparent, TSLRIC most likely errs on the side of overstating the economic cost for U S WEST's services.

42. In approving U S WEST's request to flexibly price in Glendive and Terry, the Commission neither concludes whether any cross subsidies exist nor decides how to identify cross subsidies. Although such a technical matter is appropriately addressed in a cost of service and pricing docket, this issue may be revisited in any subsequent U S WEST flexible pricing applications.

¹²See the U S WEST and MCC Stipulation in Docket No. 96.12.220.

43. Third, although Mr. Hayhurst testified that U S WEST was not seeking to flexibly price nonrecurring charges in this Docket, the tariff as filed appears to contain maximum rates for nonrecurring charges. Although it included maximum rate language in this tariff filing, U S WEST also stated its testimony relating to nonrecurring charges was intended only to distinguish costs for recurring and nonrecurring services. *See* U S WEST's supplemental response to Data Request PSC-010(e). Because the stated intent of U S WEST's filing is to apply flexible pricing to recurring charges only, the Commission requires U S WEST to file tariffs that delete references to maximum rates for nonrecurring services.

III. Conclusions of Law

1. The Commission has authority to supervise, regulate and control public utilities. Section 69-3-102, MCA. U S WEST is a public utility offering regulated telecommunications services in the State of Montana. Section 69-3-101, MCA.

2. The Commission has authority to do all things necessary and convenient in the exercise of the powers granted to it by the Montana Legislature and to regulate the mode and manner of all investigations and hearings of public utilities and other parties before it. Section 69-3-103, MCA.

3. Adequate public notice and an opportunity to be heard has been provided to all interested parties in this Docket, as required by the Montana Administrative Procedure Act, Title 2, Chapter 4, MCA.

4. The Commission may authorize the provision of regulated telecommunications service under terms and conditions that best serve the policy of state of Montana, and may

authorize permissible price ranges if the resulting minimum rates are cost compensatory.

Sections 69-3-807(2)(c), MCA.

IV. Order

THEREFORE, based upon the foregoing, it is ORDERED that U S WEST Communications, Inc.'s application to flexibly price selected services in its Terry and Glendive exchanges is approved as discussed herein.

It is FURTHER ORDERED that U S WEST shall file replacement tariffs that delete reference to maximum rates for nonrecurring services.

DONE AND DATED this 23rd day of June, 1998, by a vote of 3-1.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

DAVE FISHER, Chairman

BOB ANDERSON, Commissioner

DANNY OBERG, Commissioner, dissenting

BOB ROWE, Commissioner

ATTEST:

Kathlene M. Anderson
Commission Secretary

(SEAL)

NOTE: Any interested party may request the Commission to reconsider this decision. A motion to reconsider must be filed within ten (10) days. See ARM 38.2.4806.

Dissent of Commissioner Danny Oberg
Docket No. D97.7.125
Order No. 5998d

This Commissioner finds that while he agrees that the Commission acted correctly in granting price flexibility in the Terry and Glendive exchanges he also finds that the limitations and Commission findings in the order are so onerous that I must respectfully dissent from the Commission majority. It is my determination that this decision:

- 1) Is contrary to the public policy goals in 69-3-802, MCA, to both encourage competition and preserve universal service,
- 2) Denies customers the benefits of competition and thwarts the public policy goals established by the US Congress in passing the Telecommunications Act of 1996 (TA96),
- 3) Encourages new entrants to use the regulatory processe with its inherent time lag as leverage to advantage themselves in the marketplace,
- 4) Unfairly disadvantages the incumbent to respond to new competitive price offers in a timely manner, and
- 5) Indicates the Commission has not made the appropriate conclusions about how customers will respond from this very specific Montana “laboratory” as a prognastication of how customers actually react to competition ----- in contrast to generally accepted theory.

Background

In 1996, the US Congress passed landmark legislation that opened the local exchange market to competition. The legislation removed the monopoly formerly held by the local exchange carriers and dictated several options for new entrants clearly designed to encourage and facilitate a quick transition from a monopoly era to robust competition. Evidently, policy makers believed that their experience in motor carrier deregulation, natural gas partial deregulation, banking reform, and long distance telephone deregulation had delivered societal and consumer benefits and sought to extend those same benefits to the local exchange markets. Regulators and consumer advocates were wary of the new paradigm, but Congress overwhelmingly passed the legislation. Only a handful of House members opposed it. State regulators now play a pivotal role in implementing this legislation.

It is my belief that this Commission must judge issues before us in view of broad public policy goals of both state and federal law. Neither federal nor state law contradicts each other. Both directives embrace competition and universal service as compatible and equal policy considerations. Given that, I believe there are two critical questions that override all other considerations when regulators decide issues:

- 1) Does the proposal move us toward robust competition in a fair manner, and
- 2) Will universal service be preserved by the proposal?

If the answer to either question is in the negative, then regulators must be cautious and impose conditions and terms more consistent with furthering these public policy goals. On the other hand, if the responses to these questions are positive then the regulator must be at least as cautious in imposing its will and let the competitive marketplace work without interference.

The Competitive Model

In the monopoly world consumers were offered protection from monopolistic pricing by rigid tariffs offered on a nondiscriminatory basis developed after exhaustive cost of service and generally rate base rate of return proceedings. In a competitive world, it is generally accepted that a fair price is established when more than one seller is vying for the consumers sale through price, service or a combination of the two. Success is determined by the strategy that wins the sale. A key element in winning and retaining market share is a more or less sophisticated form of “haggling” takes place where offers are made, counter offers extended and the customer makes his selection at least partially based upon the offers of the vendors. Antitrust allegations of price fixing are generally made when this process does not work and the seller rather than the buyer largely determines price.

Moving from Monopoly Markets to a Competitive Model

Policy makers recognized that in the delivery of telecommunication services there would be a transition period due to capital requirements and time required to develop infrastructures. As such, regulation would have to monitor the market to insure that former monopoly providers would not thwart the development of competition.

During this transition period as telephone markets have been opened there have been some widely held beliefs that have influenced the development of transitional policy and regulation. I think it is important to review some of these:

- 1) That competition would develop from large population areas and high volume business customers first and migrate slowly, if ever, to low population rural areas and low volume residential,

- 2) That effective competition with incumbents would emerge first from industry giants like AT&T with huge capital access and ability to provide both local, toll and other ancillary services, and
- 3) That customer inertia to change and loyalty to the incumbent provider would hamper the development of competition.

In addition to these three assumptions there is another often unspoken, but readily apparent assumption that I believe has characterized regulatory response in developing transitional policies:

- 4) That the incumbent has such an advantage that the regulator may, in effect, impose restrictions on the incumbent to allow new entrants to capture market share. Rather than promote an “even playing field” as often is proclaimed, many apparently believe “tying one arm of the incumbent behind its back” is an appropriate regulatory strategy and that without this regulatory intervention competition will not develop.

It is my opinion that local exchange competition has emerged in Montana counter to these conventional beliefs. Rather than AT&T or other industry giants capturing the commercial and business districts of urban centers like Missoula or Billings, competition for US West customers has been from niche players and the cooperatives. In this instance, two unlikely markets, Terry and Glendive, have become the first battlefields for market share, and from all reports, it appears that David has slain the Giant. Jerry Anderson, manager of Mid Rivers, has declared in “Telecommunications Reports” (a trade journal) and in the Billings Gazette of his company’s success in capturing the lion’s share of the market. These pronouncements were made long before this order was approved. Mid Rivers is to be congratulated for its aggressive facility deployment, innovative approaches to meeting customer demands and astute marketing of both service and product packages.

US West, meanwhile, appears to suffer the lack of agility and speed of many corporate monoliths. They were slow to respond to competition and failed to provide a competitive product. Mid Rivers' market entrance was not unexpected and yet US West failed to file for regulatory approval of this tariff early enough so that it could meet the challenge. While the effect on earnings for US West as a corporation are probably not noticeable and lost at the rounding of the 10th figure beyond the decimal point, I hope US West has heeded the lessons of this experience.

The Montana Public Service Commission's job is not to determine winners or losers in the marketplace or attempt to regulate any outcome. This agency must function not to protect any competitor but to protect competition. And just as US West must reevaluate its competitiveness, this Commission must review its policies in view of this real world experience.

As the Commissioner from this geographic area, I have watched this initial fray closely, spoken to many customers and reviewed the record closely. I have reached the following conclusions:

- 1) Incumbency has proven to be of little value to US West. It appears to me that a combination of bad press over poor service, US West's work force reductions, its inability to respond with flexible pricing and lethargy in responding have diminished any expected loyalty to the incumbent.
- 2) US West may, in fact, be the handicapped player in Montana markets, especially when the competitor is a cooperative or a Montana based company. The cooperative spirit is strong in Montana and US West appears to be perceived in the same light as other historical corporate entities ----- as out-of-state companies like to Anaconda Copper Company out to use Montana as a cash cow and offering little in return. Prairie Populism is alive and well in Montana!

- 3) Customers appear to be responsive to both price, service, and product packaging. Customers appear willing to switch carriers even when price differences are fairly minimal. In addition, it appears the ability of a provider to package combinations of telephone, Internet and cable TV may be a determinative factor in the exercise of customer choice.
- 4) Current regulatory practices are inadequate to allow the regulated carrier to compete effectively. This Commission reacted appropriately and timely in granting US West pricing flexibility on an interim basis so as not to handicap the incumbent. From my conversations with customers, it appears to me that interim prices are inadequate to the customer who perceived too much risk of the Commission rejecting the proposal and responded to a firm contractual guarantee from the marketplace challenger.
- 5) That regulatory lag is a serious impediment and must be addressed. This case was filed on July 17, 1997 and eleven and a half months later is only now rendering a decision. I am disturbed that such delay will be a powerful signal to potential new entrants that it will become a tool to be used to leverage market success. Whatever the eventual outcome, it appears to me that marketplace challengers will find that demanding a hearing and using the regulatory process to impede the incumbent will become part of a marketing strategy.

This Commissioner is not intent on preserving US West's market share. In fact, I am somewhat indifferent to the consequences to US West. While I recognize that until competition is pervasive across the state, declining market share may have an adverse effect on remaining monopoly customer prices and universal service impacts, they are not the reason for this dissent. If US West revenues and market share fall because of customer choice in a fair and open business atmosphere, then I believe the system has worked. However, if US West loses customers because of regulatory barriers or impediments that are not absolutely necessary then I

believe the system has failed to allow US West a fair opportunity to participate in the marketplace.

Customers are Denied the Benefits of TA96.

TA96 was presumably passed by Congress with the belief that the competitive model would maximize customer welfare through price benefits, product innovation and quality of service considerations. In a typical competitive model, the new entrant (Company B) makes a business decision that it can sell a product or service and capture some market share of the incumbent (Company A). To retain market share, Company A is then presumably required to respond by matching or beating the offering of upstart Company B. If Company B finds its current offerings insufficient to capture sufficient market, it may then further reduce prices, add additional value to its offerings with other products, service, or other enhancements which will force a response from the incumbent Company A. The customer, through his choice, becomes the determinative factor in success. Presumably, customers win from the exchange.

I believe the current regulatory scheme is denying customers the benefits Congress promised them. The bartering and the competitive action and reaction typical of the competitive model is not taking place so customer welfare gain is not being maximized. In this instance, the full competitive response is being denied. Mid Rivers was able to offer what they believed to be a superior offering. Through the interim approval of this tariff US West was able to respond but the competitive exchange stopped at that point. Further offers and counter offers did not take place.

I am further disturbed that the unregulated new entrant has the ability to require long term contracts and creative packages while the incumbent has been handicapped by restrictions that deny the same flexibility. In a related manner this Commission also denied US West's request to offer promotions to win back customers who have left the system. In concert, these rejections darken the picture of a Commission that has generally been supportive of competition.

Intervenors Arguments Should Have Been Rejected

As the majority opinion points out, Montana Independent Telephone Systems (MITS) and the Montana Telephone Association (MTA) appear to argue that giving the incumbent pricing flexibility, except after hearing, may hinder the emergence of competition as new entrants may be hesitant unless they know the price of the incumbent. I believe such arguments are self serving and should have been rejected. In a competitive world, firms develop their business place based not only on the incumbent's present price, but also on what they believe the likely strategic marketing of the incumbent will be. The protections warranted for the new entrants are already law - prohibitions against predatory pricing and cross subsidies. The Commission should concern itself only with the minimum floor price and a maximum ceiling price of tariffed rates. Between that band, the incumbent should be free to price competitively in exchanges where competitive offers are offered to all customers.

I do concur with MITS' original assertion that benchmarks should be established to govern granting of pricing flexibility, rather than case by case. There is certainly sufficient information in this docket and in the expertise of the Commission to issue such benchmarks now.

Summary

Although the numbers may be minimal, the Terry experience has been most instructive. Regulators, new entrants and incumbent providers can disregard the lessons at their own peril. With this knowledge of the impending competition and the Commission's own expertise, I believe a more appropriate response is in order than the one established in the majority order. It appears to me that competition will soon be a reality rather than a promise. The forms that appear imminent:

- 1) Further cooperative ventures as current interconnection agreements have been amended as approved to allow deployment in major US West markets.

- 2) Montana Power Company, through its telephone subsidiary, Touch America, will soon be offering service across the state.
- 3) While unknown when the Commission decided this case, it appears that the pending AT&T and TCI merger will create competition across Montana.

The Terry model shows that customers respond to cooperative offers, that the appeal of service from a Montana based company is greater than from a regional out-of-state company like US West, and that customers do react favorably to the packaging of telephone services and cable TV.

As such, I believe US West is vulnerable to market share loss and this Commission need not handicap US West with regulatory delays and restrictions to allow competition to emerge.

This Commission had an opportunity to fulfill the promise of TA96. Customers, not US West, would have been the real winner had US West's application been approved. With the majority ruling we have once again said the regulatory hearing room is where prices will be set and market share can be won and lost while the lawyers, economists and politicians argue theory. The Terry experience was reality, but it appears that we would rather deny the lessons of Terry than move forward with appropriate lessons.

I wonder how many Terry-like results it will take before this Commission frees US West from the unnecessary restrictions placed upon it. It remains to be seen whether US West can cease its lethargy and become an agile and timely competitor in the marketplace. What I find certain is that this Commission should unleash the chain it has placed upon US West and let the marketplace work. I support flexible pricing, detariffing, and waiving of non-recurring service fees as appropriate in any local exchange area upon notification to the Public Service Commission that local service is being offered non-discriminately within an exchange or provided by a competing facility based provider or by a competing local exchange carrier through the purchase of unbundled elements. The majority opinion is too cautious, too skeptical of US West and too gullible to the self serving arguments of the new entrants. The Commission should have had a

more bold response that would have maximized consumer welfare as competing carriers fought for the consumers hearts and dollars in the marketplace. The time should have passed for regulatory maneuvering, but the majority decision guarantees US West and new entrants will fight again in the regulatory arena before the action truly happens in the marketplace. Granting US West's application in full would have neither harmed the emergence of competition nor posed threats to universal service. As such, the application should have been approved.

Danny Oberg
Commissioner